DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200221050

Date: Feb. 25, 2002

Contact Person:

Identification Number:

T:EO:B2

Telephone Number:

Employer Identification Number:

U.I.L. Nos.
501.03-02
507.05-00
507.02-00
4940.02-01
4941.04-00
4941.03-00

LEGEND:

X =
Y =
Z =

Dear Sir or Madam:

This is in response to X's letter dated November 21, 2001, in which X requested certain rulings with respect to a proposed transfer by X of 25% of its assets to Y and 25% to Z.

X is exempt under section 501(c)(3) of the Internal Revenue Code and is classified as a private foundation under section 509(a). Both Y and Z have received determination letters stating they are tax-exempt under section 501(c)(3) of the Code and classifying them as private foundations under Section 509(a).

Because of a divergence in the charitable interests, grant-making strategies and investment philosophy of its directors, X made the decision to reorganize. X proposes to transfer approximately 25% of X's investment assets to Y and 25% to Z. X will continue its existence after the transfer of assets. X, Y and Z, which are managed by individuals related by blood or marriage, have overlapping trustees and directors so that the same persons effectively control X, Y and Z. Following the asset transfer, some directors of Y and Z will resign, and new directors will be appointed.

X represents that X will have no undistributed income for the taxable year of the asset transfer due to the application of excess qualifying distributions made in prior taxable years pursuant to Section 4242(i) of the Code. X further states that the asset transfer will not otherwise be for consideration. X will exercise expenditure responsibility under Section 4945(h) of the Code and 53.4945-5(c)(2) of the Foundations and Similar Excise Taxes Regulations with respect to the transfers.

X requests the following rulings:

1. That the Asset Transfer will not affect the status of X under 501(c)(3);
2. That the Asset Transfer constitutes a transfer described in Section 507(b)(2) of the Code;
3. That the Asset transfer will not terminate X as a private foundation under Section 507(a), and will not result in termination tax under 507(c);
4. That the Asset transfer will not be treated as a sale or other disposition of property that gives rise to net investment income for purposes of Section 4940 of the Code and the tax basis and holding period of the transferred assets in the hands of Y and Z shall be determined in the same manner as if such assets had continued to be held uninterruptedly by X;
5. That the Asset Transfer will not be an act of self-dealing for purposes of Section 4941 of the Code by X, Y or Z or any disqualified person with respect to X, Y or Z;
6. That the Asset Transfer will carry over to Y and Z a proportionate percentage of X's excess qualifying distributions carryover from X's prior years under Section 4942 of the Code equal to the percentage of the fair market value of X's net assets transferred to Y and Z pursuant to the Asset Transfer.

Section 507(a) of the Code provides for the voluntary and involuntary termination of private foundation status. It states, in part, that except for transfers described in section 507(b), an organization's private foundation status will be terminated only if (1) the organization notifies the Service of its intent to terminate or (2) there have been either willful repeated acts (or failures to act), or a willful and flagrant act (or failure to act) giving rise to liability for under Chapter 42.

Section 507(b)(2) of the Code provides that in the case of a transfer of assets of any private foundation to another private foundation pursuant to any liquidation, merger, redemption, recapitalization, or the adjustment, organization or reorganization, the transferee foundation shall not be treated as a newly created organization.

Section 507(c) of the Code imposes an excise tax on an organization that terminates its private foundation status under section 507(a).

Chapter 42 imposes excise taxes on private foundations for net investment income under section 4940(a) of the Code, acts of self-dealing under section 4941, undistributed income under 4942(a), excess business holdings under section 4943(a), jeopardizing investments under section 4944(a), and taxable expenditures under section 4945(a).

Section 4940 of the Code provides for the imposition of a tax on the net investment income of private foundations.

Section 4945 of the Code imposes an excise tax for taxable expenditures, including grants to organizations not qualified under section 509(a) of the Code, unless expenditure responsibility is exercised.

Section 1.507-1(b)(6) of the Regulations provides that in a transfer of all or part of a private foundation's assets to one or more private foundations pursuant to a transfer described in section 507(b)(2) of the Code and section 1.507-3(c), such transferor foundation will not have terminated its private foundation status under section 507(a)(1).

Section 1.507-1(b)(7) of the Regulations provides that neither a transfer of all the assets of a private foundation nor a significant disposition of assets by a private foundation shall be deemed to result in a termination of the transferor private foundation under section 507(a) of the Code unless the transferor private foundation elects to terminate pursuant to section 507(a)(1) or section 507(a)(2) is applicable.

Section 1.507-3(a)(1) of the regulations provides that in the case of a significant disposition of assets to one or more private foundations within the meaning of 1.507-3(c), the transferee organization shall not be treated as a newly created organization. A transferee organization to which this paragraph applies shall be treated as possessing those attributes and characteristics of the transferor organization which are described in sections 1.507-3(a)(2), (3), and (4).

Section 1.507-3(a)(9)(i) of the regulations provides that if a private foundation transfers all of its net assets to one or more private foundations which are effectively controlled (within the meaning of section 1.482-1(a)(3)), directly or indirectly, by the same person or persons which effectively controlled the transferor private foundation, each transferee foundation will be treated as if it were the transferor foundation, for purposes of sections 4940 through 4948 and sections 507 through 509 of the Code. Each transferee is treated as if it were the transferor in the proportion which the fair market value of the assets (less encumbrances) transferred to the transferee foundation bears to the fair market value of the assets (less encumbrances) of the transferor immediately before the transfer.

Section 1.507-3(c)(1) of the regulations provides that for purposes of section 507(b)(2) of the Code, the terms "other adjustment, organization or reorganization" shall include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for full and adequate consideration or distributions out of current income.

Section 1.507-3(c)(2) of the regulations provides that the term "significant disposition of assets to one or more private foundations" shall include any disposition for a taxable year where the aggregate of the dispositions to one or more private foundations for the taxable year, is 25 percent or more of the fair market value of the net assets of the foundation at the beginning of the taxable year

Section 1.507-3(d) provides that a transfer described in section 507(b)(2) will not constitute a termination of the transferor's private foundation status under section 507(a)(1).

Section 53.4945-5(c)(2) and section 53.4945-5(d)(1) of the Foundation and Similar Excise Tax Regulations provide that certain endowment grants from private foundations to other private foundations necessitate expenditure responsibility reports from grantees and grantors for only three years.

Section 53.4946-1(a)(8) of the foundation regulations provides that for purposes of section 4941 of the Code only, the term "disqualified person" does not include any organization described in section 501(c)(3) (other than an organization described in section 509(a)(4)).

Rev. Rul. 78-387, 1978-2 C.B. 271, describes the carryover of a transferor private foundation's excess qualifying distributions under section 4942(I) of the Code where the transferor and the transferee foundations are controlled by the same persons under section 1.507-3(a)(9)(i) of the regulations and the transferor transfers all of its net assets to the transferees. The transferee is treated as the transferor so that the transferee can reduce its own distributable amount under section 4942 of the Code by its share of the transferor foundation's excess qualifying distributions under section 4942(i) of the Code.

X will transfer 25% of its assets to Y, and 25% to Z, with Y and Z being private foundations. The percentage of assets being transferred will be 25% or more of total assets, making it a significant disposition as defined by section 1.507-3(c)(2) of the Regulations and a section 507(b)(2) transfer. Thus, X's private foundation status has not been terminated as X has not made a voluntary termination under section 6507(a) of the Code. Further, under section 1.507-3(d) of the Regulations, the section 507(b)(2) transfer is not treated as a termination.

Since there is no termination under section 507(a) of the Code, there is no termination tax under section 507(c) of the Code.

Under sections 1.507-3(a)(1)-(4), Y and Z will succeed proportionately to certain tax attributes and characteristics of X. Consistent with this carryover of tax attributes, and given the transferor foundation's consent as evidenced by its ruling request, Y and Z will each succeed to 25% of X's excess qualifying carryover distributions under section 4942(i).

The transfer does not result in the imposition of tax on investment income under section 4940 of the Code. Section 4940 imposes an excise tax on investment income received by private foundations. Investment income includes capital gains from the sale or other disposition of property. The transfer of assets by X to Y and Z, which lacks consideration, is considered a gift rather than a "sale or other disposition of property" and so does not generate capital gain that would be subject to the section 4940 excise tax. Consequently, the holding period and tax basis for the assets transferred to Y and Z will be the same as that for X.

Y and Z have been recognized as private foundations exempt under section 501(c)(3) of the Code. Therefore, the transfer by X of assets to Y and Z will be a transfer from a private foundation to two other private foundations. Under section 53.4946-1(a)(8), section 501(c)(3) organizations are not disqualified persons, so that the transfer of assets from X to Y and Z will not involve disqualified persons. Accordingly, there will be no self-dealing within the meaning of section 4941 of the Code.

Accordingly, based on the information furnished, we rule as follows:

1. That the asset transfer from X to Y and Z will not affect the status of X under 501(c)(3).

2. That the asset transfer constitutes a transfer as described in 507(b)(2) of the Code.

3. That the asset transfer from X to Y and Z as outlined in the proposed transaction will not terminate X as a private foundation under 507(a), and that there will be no termination tax assessed under section 507(c) of the Code.

4. That the asset transfer will not be treated as a sale or other disposition of property which would give rise to net investment income under Section 4940 of the Code, and that the basis and holding period of the assets transferred from X to Y and Z shall be determined in the same manner as if such assets had continued to be held uninterruptedly in the hands of X.

5. That the proposed transaction will not be considered self-dealing under section 4941 of the Code.

6. That the asset transfer will carry over to Y and Z a proportionate percentage of X's excess qualifying distributions carryover from X's prior years under Section 4942 of the Code equal to the percentage of the fair market value of X's net assets transferred to Y and Z pursuant to the asset transfer.

This ruling is directed only to X, Y and Z. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Because this letter could help resolve any future questions about tax consequences of X's activities, X should keep a copy of this ruling in X's permanent records.

If X has any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2